Global Economic Outlook

Assessing Risks and Opportunities

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The world economy is gradually recovering from the downturn of 2001. There is enough data available for 2002 to estimate that world growth for the year is approximately 3 percent. Compared with past recoveries, the current one is slow and tenuous. The outlook for 2003 is that the world economy will grow by around 3.4 percent, a rate of growth that is about average for the last two decades. The world economy is not expected to reach its long-term potential rate of growth of approximately 4.5 percent per year until late 2003 or early 2004.

The major characteristics of the current economic cycle are that the cycle has been fairly synchronized across most major economies and that the economic meltdown in high-tech information and telecommunications industries played an important role as the downturn spread throughout the world.

Table 1 reveals the global nature of the downturn. In industrial economies, economic growth fell from 3.5 percent in 2000 to only 0.8 percent in 2001. Minimal growth in the United States and Europe, as well as negative growth in Japan, explains much the slowdown. Only Australia (among the industrial countries listed in the table) maintained a semblance of normal growth. In 2002, with moderately better growth in the United States and very good growth in Canada and Australia, the record for industrial economies improved a little. However, slower growth in Europe and continued recession in Japan will keep the overall growth rate for this group of countries well below potential through 2003.

Among emerging markets, recession is evident predominantly in Asia and Latin America. In Asia, the high dependence on the United States as a market for exports, particularly in telecommunications and computer products, severely undercut growth (especially in Taiwan, Hong Kong, Singapore, the Philippines, and Malaysia). U.S. imports of manufactured goods in 2001 from these five markets fell from between 12 percent (Malaysia) and 22 percent (Singapore). Continued strong growth in China during 2001 was responsible for keeping the slowdown in the region to a minimum compared with growth in 2000. China accounts for nearly half of the output in emerging Asia (excluding Japan, Australia, and New Zealand). Overall, growth in Asian emerging markets is estimated to have increased to just under 6 percent in 2002. The aggregate forecast for these markets is just over 6 percent in 2003.

Another important weak spot among emerging markets in 2001 was in Latin America, where growth slowed dramatically in 2001 before falling into negative territory in 2002. Much of the slowdown in 2001 was centered in three countries: Argentina (-4.4 percent growth), Mexico (-0.3 percent growth), and Brazil (1.5 percent growth). These three countries account for 10 percent, 23 percent, and 32 percent, respectively, of total Latin American output. In 2002, the estimated 0.7-percent decline in Latin American output occurred mainly in Argentina, where output plummeted by about 16 percent, and in its neighbor, Uruguay, where output fell by 11 percent. Meanwhile, in Venezuela, political turmoil has disrupted petroleum production. The economy there declined by over 6 percent in 2002. Sluggish growth of 1.5 percent in the two Latin American giants, Brazil and Mexico, was not enough to offset these serious recessions for the group. The prediction for 2003, with significant uncertainties, is that growth will reach 3 percent.

Compared with the industrial economies and emerging markets, the transition economies enjoyed relatively strong growth in 2001, even though growth was less than the 6.6-percent rate in 2000. When data for 2002 is complete, this group of countries is expected to record a solid rate of growth of 3.8 percent. The forecast for 2003 is that growth will accelerate slightly to around 4.4 percent. Within this group of economies, Russia and Poland are predominant, with 43 percent and 13 percent, respectively, of total group output. Strong growth in Russia, ensuing from higher energy prices and large export surpluses, helped offset sluggish growth in Poland. The Polish economy grew by

TABLE 1. WORLD, REGIONAL, AND COUNTRY GROWTH

(in percent)	1998	1999	2000	2001	2002 Estimate	2003 Forecast
World	**2.7**	**3.6**	**4.7**	**2.2**	**2.7**	**3.4**
Industrial Economies	**3.0**	**3.2**	**3.5**	**0.9**	**1.5**	**2.1**
United States	4.3	4.1	3.8	0.3	2.4	2.6
Canada	4.1	5.4	4.5	1.5	3.4	3.2
Japan	-1.2	0.7	2.8	0.3	-0.5	0.7
European Union	**2.9**	**2.8**	**3.5**	**1.6**	**1.0**	**1.8**
United Kingdom	2.9	2.4	3.1	1.9	1.6	2.5
Euro area	**2.9**	**2.8**	**3.6**	**1.5**	**0.7**	**1.7**
Germany	2.0	2.0	2.9	0.6	0.3	1.1
France	3.5	3.2	4.2	1.8	1.0	1.8
Italy	1.8	1.6	2.9	1.8	0.4	1.5
Australia	5.2	4.8	3.1	2.6	3.0	3.0
Emerging Markets	**3.0**	**4.2**	**5.9**	**3.6**	**4.0**	**5.1**
Africa	**3.0**	**2.7**	**3.1**	**3.4**	**2.8**	**4.0**
Sub-Saharan Africa	2.7	2.8	3.2	3.3	2.9	4.2
Asia	**3.2**	**6.4**	**7.0**	**5.0**	**5.9**	**6.1**
China	7.8	7.1	8.0	7.3	7.5	7.2
India	5.8	6.7	5.4	4.1	5.0	5.7
NIEs	**-2.4**	**7.9**	**8.5**	**0.8**	**4.5**	**4.9**
South Korea	-6.7	10.9	9.3	3.0	6.1	5.8
ASEAN	**-7.3**	**3.5**	**5.5**	**2.6**	**3.8**	**4.4**
Indonesia	-13.1	0.8	4.8	3.3	3.5	4.5
Middle East	**3.3**	**0.8**	**5.8**	**0.7**	**3.1**	**4.2**
Latin America	**2.3**	**0.2**	**4.0**	**0.6**	**-0.7**	**2.8**
Brazil	0.2	0.8	4.4	1.5	1.5	3.0
Mexico	5.0	3.6	6.6	-0.3	1.5	3.3
Transition Economies	**-0.7**	**3.7**	**6.6**	**5.0**	**3.9**	**4.4**
Central and Eastern Europe	**2.4**	**2.2**	**3.8**	**3.0**	**2.8**	**3.6**
Poland	4.8	4.1	4.0	1.0	1.2	2.5
CIS	**-2.8**	**4.6**	**8.4**	**6.2**	**4.5**	**4.8**
Russia	-4.9	5.4	9.0	5.0	4.4	4.9
Ukraine	-1.9	-0.2	5.9	9.1	4.8	5.0
Top 20 U.S. Markets						
For manufactured goods	2.8	3.8	5.1	2.7	2.8	3.4

Source: Historical data from the IMF; forecast data from the ITA, U.S. Department of Commerce.

only 1 percent in the last two years, following several years of rapid economic development in the 1990s.

Two developments stand out in an assessment of the 2002 world economy. First, after declining for five consecutive quarters beginning in the fourth quarter of 2000, U.S. imports surged in the first half of 2002. Much of the increase was the result of normal cyclical inventory restocking by U.S. companies plus some early precautionary purchases in advance of the threat of the West Coast dock strike. The rapid increase in imports provided a boost to several U.S. trading partners, particularly in Asia. The second noteworthy development of the current recovery is that throughout industrial countries, monetary and fiscal polices have been expansionary. In the United States, monetary and fiscal policies became supportive of economic growth almost at the outset of the economic downturn. Without the stimulus from the sharp move to a fiscal deficit from a fiscal surplus in the federal budget, the downturn would certainly have been worse. Likewise, the reduction of interest rates by the U.S. Federal Reserve helped to stimulate spending on automobiles and other big-ticket items, although business investment spending has shown only a small signs of recovery. Additionally, low inflation in the United States has helped to keep long-term interest rates at 30-year lows, a trend which has helped feed the continuing boom in home construction.

While the economies of Europe were slowing, automatic spending and tax stabilizers provided a fiscal boost, but countries within the euro area of the European Union are now facing fiscal restraints under the EU Growth and Stability Pact. The pact limits the size of a country's fiscal deficit to 3 percent of GDP. As European economies have slowed, revenues have fallen and social spending has increased. Several euro area countries have found their budgets near or over the 3-percent limit, and, under the provisions of the pact, they face the necessity of either cutting spending or raising taxes. Two countries, Portugal and Germany, have exceeded the limit while France and Italy are near it and may exceed it barring a return of faster growth. At the same time, monetary policy in the euro area has been restrictive. The focus of the European Central Bank (ECB), by design, is on controlling inflation with an inflation target of 2 percent or less. Since inflation in the euro area has been running at an annual rate of around 2.5 percent, the ECB did not reduce rates for over a year until December, when rates were cut by 0.5 percentage points. The ECB has not been as aggressive in its monetary policy as the U.S. Federal Reserve, but it is hoped that this recent cut in interest rates will provide some stimulus to the economies of Europe.

In Japan, neither monetary nor fiscal policy has been able to return the economy to normal rates of growth for much of the last decade. Interest rates have been at or near zero percent for several years, but Japanese banks are carrying so much bad debt that they have been unwilling or unable to make new loans with the result that credit has been shrinking and prices have been falling. Japan has instituted several rounds of aggressive fiscal policy actions over the decade. These efforts have had moderate success, and they have succeeded in keeping the economy from falling into a serious depression. But as a result of deficit spending and the continuing sluggish economy, Japan's national debt is growing rapidly and becoming a serious concern. Japan has launched a series of reforms to rid the banks of non-performing loans, but these efforts have not been very aggressive or effective. A new governor of the Japanese central bank will be appointed soon, and there is hope that the new governor will be more aggressive in the use of monetary policy.

The economic stimulus of expansionary monetary and fiscal policy throughout much of the industrial world and in a few emerging markets, most importantly China, has been an important force in recovery. In opposition to the expansionary government policies, a handful of notable problems are slowing or threatening to slow the economic rebound. First, the investment boom that fueled the bubble in telecommunications, information technology, and several other industries has left an overhang of capital investment. As a result, investment is lagging in several economies. In the United States, for example, business fixed investment barely turned positive in the third quarter after seven consecutive quarters of decline. Low business confidence, equity prices that are well below record highs and that continue to fall in several markets, and the aforementioned excess capacity are keeping business investment in check.

Another brake on economic growth is the fact that oil prices have been rising, in part as a reflection of uncertainty over the situation in the Middle East and in part because of political turmoil in Venezuela. According to White House estimates, every $10 increase in oil prices cuts 0.25 to 0.50 percentage points from U.S. growth. Finally, with regard to a U.S. recovery, the continued strength of consumer spending and the large and growing U.S. trade deficit are important forces behind the rebound in the U.S. and world economies. Should U.S. consumers, now carrying unprecedented levels of debt, increase their savings to more traditional levels, an important stimulus to the recovery would disappear.